BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 95-1202-E – ORDER NO. 2001-663

JULY 24, 2001

IN RE: Pacolet River Power Company, Inc., Complainant, vs. Duke Power Company n/k/a Duke Power, a division of Duke Energy Corporation, Respondent	)	ORDER ON REMAND DISMISSING AND DENYING COMPLAINT

INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (the Commission) on remand from the South Carolina Supreme Court (the Court) for a trial de novo of a complaint matter between Pacolet River Power Company, Inc.(Pacolet) and Duke Power Company (Duke Power). By order dated March 23, 2000, the Court granted a joint motion of the parties to dismiss the original appeals of the case and remand for a new trial by the Commission on four issues in the case:

(1) The existence of a legally enforceable obligation under the Public Utility Regulatory Policies Act of 1978 (PURPA);

(2) The appropriate length of a contract (Purchased Power Agreement) entered into between Pacolet and Duke Power;

(3) Appropriate rates to be paid to Pacolet under the terms of the contract; and

(4) The issue of allegations of bad faith against Duke Power and an assessment of costs therefore.

The case stemmed from a complaint by Pacolet, a Qualifying Facility (QF) under PURPA, against Duke Power, which alleged that Duke had refused to enter into a long-term purchased power agreement at full avoided costs. Pacolet alleged that the contract length should be at least fifteen years. Pacolet further alleged that Duke failed to honor a "legally enforceable obligation," which, according to Pacolet, accrued with a June 24, 1994 letter. Finally, Pacolet alleged that Duke Power had acted in bad faith in its dealings with Pacolet, and that Duke should be assessed costs accordingly.

The trial de novo was held on January 23, 2001 at 2:30 PM in the offices of the Commission. Pacolet, represented by William E. Booth, III, Esquire, presented the testimony of Charles B. Mierek, the President of Pacolet, and Tiane L. Sommer, an expert witness. Duke Power, represented by Richard L. Whitt, Esquire, and Jeffrey M. Trepel, Esquire, presented the testimony of Janice D. Hager, Kenneth B. Keels, Jr., and Philip T. Lacy. The Commission Staff, represented by F. David Butler, General Counsel, presented the testimony of A.R. Watts, Chief of Electric in the Commission's Utilities Department.

BACKGROUND

The testimony of Charles Mierek reviewed the history of PURPA. Tr., Mierek, at 21-24. According to Mierek, PURPA was enacted during the energy crises of the late 1970's to encourage the development of cogeneration and small power production facilities, and to thus reduce American dependence on fossil fuels. Congress sought to eliminate two significant barriers to the development of alternative energy resources: (1) the reluctance of traditional electric utilities to purchase power from and sell power to non-traditional facilities, and 2) the financial burdens imposed upon alternative energy sources by state and federal authorities. Section 210 of PURPA specified the benefits to which QFs are entitled. It creates a market for their energy by requiring that the Federal Energy Regulatory Commission (FERC) establish regulations that obligate public utilities to sell electric energy to and purchase electric energy from QFs. The section requires FERC to promulgate regulations to ensure that the rates for these purchases "shall be just and reasonable to the electric consumers of the electric utility and in the public interest." However, these rates may not exceed the incremental cost to the utility of purchasing alternative electric energy. The incremental cost is defined as "the cost to the electric utility of the electric energy which, but for the purchase from such [QF], such utility would generate or purchase from another source."

In 1980, the FERC promulgated regulations pursuant to Title II of PURPA. A portion of these regulations provide the rules for the purchase of energy by utilities as required by Section 210 of PURPA. These require that utilities purchase electric energy from the QFs at "full avoided costs." These are utilities' incremental costs for electric energy and/or capacity which, but for the purchase from the QF, the utility would generate itself or purchase from another source. The regulations provide guidelines for the calculation of avoided costs. The utility must submit data to the state regulatory agency, which is considered by this Commission, along with other factors in calculating avoided costs. Other regulations also provide that each QF has the option to sell energy on an "as available" basis or pursuant to a contract enforceable over a specified term. If the energy is purchased pursuant to a contract, the rate for such purchases is based on either the avoided costs as calculated at the time of delivery, or the avoided costs as calculated at the time the obligation is incurred, with the choice being with the QF. The term "legally enforceable obligation" means that the QF must be ready, willing and able to sell the power.

LEGALLY ENFORCEABLE OBLIGATION

Pacolet testified through Mierek that a June 24, 1994 letter to Duke Power requesting a long term contract at the rates available at the time of the letter constituted a "legally enforceable obligation," since the project was up and operating at the time, and that Duke must, at the option of the QF provide the QF with "the avoided costs calculated at the time the obligation is incurred." Mierek states that Duke should have provided Pacolet with a long term contract with fixed energy and capacity values, with the values being fixed on June 24, 1994, the date of the establishment of the "legally enforceable obligation" by the letter. Tr., Mierek, at 23. (We would note parenthetically that Mierek wrote a "nearly identical" letter on January 30, 1993, yet he does not claim that this letter created a "legally enforceable obligation." See Tr., Mierek at 26.)

Not surprisingly Duke Power takes a different view of the matter. First, Duke witness Keels stated that the "legally enforceable obligation" is an obligation incurred by the QF to deliver the energy or capacity, not an obligation incurred by the purchasing utility. Second, Keels asserts that the June 24, 1994 letter did not create and could not create a "legally enforceable obligation," since Pacolet was already operating under an existing legally enforceable obligation under its then and now existing contract for power provision by Pacolet. Keels states a belief that a QF cannot unilaterally terminate an existing "legally enforceable obligation" and contract in order to create a "new" legally enforceable obligation to deliver the same capacity and energy under a new contract with higher rates. Keels notes that Duke Power's existing contract with Pacolet contains a termination notice period of 30 months. Tr., Keels, at 156-158.

Duke also provided the testimony of Philip T. Lacy, Dean for Academic Affairs at the University of South Carolina Law Center. Dean Lacy reviewed the facts, letters, pleadings, testimony, case law, and statutes pertinent to this case, and also concluded that Pacolet's June 24, 1994 letter did not create a "legally enforceable obligation." Because Pacolet was a party to a valid, existing contract, which was not terminated by either party, and because Pacolet was free to walk away from the negotiations without liability, in Dean Lacy's opinion, no "legally enforceable obligation" was created. Tr., Lacy, at 269-270.

LENGTH OF THE PROPOSED CONTRACT

There are a number of proposed contract lengths for the proposed contract between Pacolet and Duke Power that may be found in the record of the case. Charles Mierek of Pacolet states without qualification that a contract term of fifteen years is reasonable and appropriate. In Mierek's opinion, this term provides the stability needed for projects that are as capital intensive as hydropower projects. Mierek also states that the North Carolina Utilities Commission requires its jurisdictional utilities to provide contracts of 5, 10, and 15 years, at the sole option of the QF. Tr., Mierek, at 27. Tiane Sommer, testifying for Pacolet, states that the 15 year contract sought by Pacolet is consistent with sound regulatory policy, but that long term can mean 20 to 30 years, also. Tr., Sommer, at 107, 108.

Again, Duke Power has a different view. According to Duke Power witness Keels, Duke is not obligated under PURPA to offer Pacolet a long term contract. Section 292.304(d) of the FERC regulations permits a QF to offer power to electric utilities over a "specified term" if the QF is able to commit to producing power for the agreed upon term. Keels states that the PURPA statutes, regulations, and orders do not define a "specified term" as "long term," and they do not require an electric utility to agree to a minimum term unilaterally selected by the QF. The present contract between the parties specified an initial term of one year, continuing thereafter until terminated upon 30 months notice by either party. Tr., Keels, at 159-160.

Duke Power further states that various Commission Orders concluded that long term contracts and long term rates should not be required as part of the standard tariff package. See Commission Order Nos. 81-214, 85-347, and 89-56. Further, Keels states that contract terms of 15 years are not common in the current wholesale electric generation market, and, in fact, contract terms of less than one year are common as generators sell seasonal capacity and energy over three or four summer months. Further, Keels notes that in today's electric power markets, contracts with terms in excess of two to three years are considered long term. Uncertainty surrounding the pending deregulation of the electric utility industry is a primary factor driving the trend towards shorter-term contract obligations, according to Keels. Tr., Keels, at 161. Keels also mentions the existence of various contract lengths as 2, 3, or 4 years, and contacts of 5 or 6 years duration. The latter would expire about the time restructuring might be expected to occur. Tr., Keels, at 162. Duke's conclusion is that the longer term contracts present greater risks.

The Commission Staff, through A.R. Watts, also discussed the issue of contract lengths. Watts noted that in prior Orders addressing PURPA issues, the Commission approved standard offer tariffs based on projected two year average costs, but declined to mandate long-term rates. The Commission instead encouraged negotiation by the parties for long-term agreements. Tr., Watts, at 251. Watts also noted that the Commission has provided guidance for establishing the minimum for PURPA-related capacity associated with long-term considerations. This period would encompass a substantial portion of the utility's capacity planning horizon and should not be less than the lead time for a base load addition. Watts quotes the Utility Facility Siting and Environmental Protection Act for the proposition that the public utilities in South Carolina must file an annual report with the Commission containing a ten year forecast of loads and resources. Watts noted that a ten year contract period could be considered accordingly, although other factors could affect this length, and that this could be considered an outside time frame for such a contract. Watts states his belief that this constitutes a reliable reference for the determination of the capacity planning horizon of ten years. Watts also noted that the lead time for South Carolina Electric & Gas Company's Cope facility was something less than five years. Finally, on cross-examination, Watts agreed that combined cycle plants could be brought on with a lead time of as little as 36 months. Tr., Watts at 252, 264.

APPROPRIATE RATES

The appropriate rate for any contract between the parties is also a source of great controversy. Again, an examination of the testimony in the case offers several opinions for the Commission's consideration.

Pacolet witness Mierek states only that he believes that Pacolet is entitled to the "full avoided costs," without additional explanation. Tr., Mierek, at 31. Witness Tiane Sommer clarifies by stating that a utility has a federal-law obligation, implemented through the states, to make fixed energy and capacity payments to a QF. Tr., Sommer, at 107.

Duke Power witness Janice D. Hager testified that the avoided cost standard ensured that the utility's customers should pay rates no higher than they would have paid had the utility not purchased capacity and energy from the QF. Hager states that Section 292.304(d) of the PURPA rules discusses payment rates that are calculated on a "real-time" basis or at the time of energy deliveries from the QF as well as payment rates that are calculated and fixed at some point in time prior to the actual deliveries. Duke's practice is to negotiate with QFs for purchased power contracts based on appropriate avoided cost rates, terms and conditions for the specific transaction. Hager states that a negotiated rate would satisfy the PURPA requirement to offer rates calculated at the time the obligation is incurred. Tr., Hager, at 122-123.

Further, Hager notes that the Commission establishes the standard variable rate which provides rate certainty for QFs by fixing the rates in advance of delivery of energy, in compliance with PURPA regulations. This rate schedule is denominated the Schedule PP (SC). These rates are standardized rates that are fixed in advance of actual delivery of energy and remain fixed until changed by the Commission. Thus, according to Hager, under Schedule PP(SC), Pacolet has been the recipient of "avoided costs calculated at the time the obligation is incurred" as opposed to "avoided costs calculated at the time of delivery." Tr., Hager, at 123.

Hager states a belief that the rates presently being paid to Pacolet under its present contract are appropriate rates, i.e. rates under Schedule PP(SC). Hager notes that these are the Commission-approved full avoided cost rates for QFs located in South Carolina. Tr., Hager, at 131. Further, Hager opines that the rates presently being paid to Pacolet represent a reasonable balance between the need to encourage the efficient development of QFs and the requirement to provide just and reasonable rates to Duke's retail customers.

A. R. Watts of the Commission Staff noted that the Commission has declined to mandate long-term rates and instead has encouraged the parties to negotiate. Tr., Watts, at 258. Watts stated that the rates should be based on Duke Power's full avoided costs as required by PURPA. Further, Watts notes that the rates should take into account to the extent practicable certain factors described in PURPA, such as availability of QF power during peak periods, dispatchability, reliability, and outage scheduling capability among others. Tr., Watts, at 252.

BAD FAITH

Pacolet witness Charles Mierek testified that Duke Power has not negotiated in good faith as required by previous Orders of this Commission. Mierek states that Duke's refusal to even offer a long term agreement in June of 1994 was contrary to the requirement of this Commission that "a term of a minimum of five years must be offered." Tr., Mierek, at 32. Further, Mierek alleges that Duke Power has never recognized its obligation to purchase electricity from Pacolet at rates which equal the full avoided costs. In addition, Mierek states that Pacolet was treated differently from three QFs that entered into purchased power agreements with Duke after June 24, 1994, i.e. two agreements with H&H Properties and one with Spray Cotton Mills. Mierek notes that all three contracts were signed for 15 years at full avoided costs. Mierek then alleged that Duke failed to offer Pacolet in 1993 rates that were based upon its own most current avoided cost estimates, the proposed rates previously filed with the North Carolina Utilities Commission. Pacolet decided to continue with the rates contained in Schedule PP(SC). Mierek then details other Duke Power avoided cost rate filings.

Duke Power witness Keels denies the allegations of bad faith, and states that Duke Power has always acted in good faith in its dealings with Pacolet in a manner that is consistent with Duke's obligations under PURPA and Commission rules and orders implementing PURPA, and consistent with Duke's obligation to provide reliable, cost-effective electric service to its customers. Duke states through Keels that on six different occasions, Duke offered long term contracts with fixed rates equal to Duke's projections of its full avoided cost, even though Duke Power had no obligation to do so. Further, Keels notes that in every instance, Duke offered its full avoided cost rates, which are the maximum rates allowed under PURPA, FERC regulations and Commission orders, using the avoided cost methodology approved by this Commission and Duke's projections of full avoided cost used in the determination by the North Carolina Commission. Duke Power claims that it never proposed rates that were lower than those projections of future full avoided cost. Tr., Keels, at 166-167.

With regard to the three specific QFs mentioned by Mierek, Keels notes that all three are in North Carolina, and therefore subject to North Carolina rate schedules, and that, upon close examination, Pacolet does not even want the same rate schedule, since it "does not desire the levelized rates contained in those contracts" but "is willing to have the rates increase from year to year." Tr., Keels, at 183.

Further, with regard to the 1993 offer, Keels relates that prior to 1994, Duke always offered Commission approved rates, however, these turned out to be somewhat out of date. Duke then began using its latest projections in negotiations. In 1993, however, Pacolet never responded to Duke Power's offer. Duke's position is that at all times, it dealt with Pacolet in good faith, since it used its very latest avoided cost projections in it dealings with that Company, and, therefore, Pacolet's claims of bad faith are unfounded. Tr., Keels, at 172.

Commission Staff witness A.R.Watts observed that although Duke has an aptitude for bargaining and strong support of its positions, no bad faith took place in that Company's negotiations with Pacolet in his opinion. Tr., Watts, at 253.

MOTION TO STRIKE

Duke Power has moved to strike various portions of the direct and rebuttal testimony of Charles Mierek on the basis that Mr. Mierek is not an attorney and not familiar with contract law. Tr. at 115. The sections of Mierek's testimony, to which Duke Power alludes do appear to be related to what matters are covered or not covered by PURPA, what constitutes a "legally enforceable obligation," and other related legal matters. Although Mr. Mierek is admittedly not an attorney, he is an engineer that has had many occasions to deal with PURPA and its regulations while operating his QF. The Staff has argued in its Brief that even though Mr. Mierek is not an expert in legal matters, that he should be entitled to at least give his opinion on these matters. The Commission can then judge the testimony's value under the circumstances, and afford it whatever weight that the Commission deems appropriate. In sum, the Staff opinion is that the Motion to Strike should be denied, and the testimony be given whatever weight that the Commission deems just and proper.

CONCLUSION

We have examined the evidence in this case at length and must first conclude that the June 24, 1994 letter did not and could not create a "legally enforceable obligation," since Pacolet was already operating under an existing legally enforceable obligation under its then and now existing contract for power provision. Because Pacolet was a party to a valid, existing contract, which was not terminated by either party, and because Pacolet was free to walk away from the negotiations without liability, no "legally enforceable obligation" was created. See Tr., Lacy, at 269-270. Since no "legally enforceable obligation" was created, Duke was under no obligation to offer a new contract at all, much less a contract of a certain length and containing certain rates. In essence, our finding that no "legally enforceable obligation" was created renders the questions of contract length and the appropriate rate for said contract moot.

Further, we hold that no bad faith was demonstrated by Duke Power in its negotiation of these issues with Pacolet. Duke testified that on six different occasions it offered long term contracts with fixed rates equal to Duke's projection of its full avoided cost, even though it had no obligation to do so, and that, in every instance, it offered its full avoided cost rates, which are the maximum rates allowed under PURPA, FERC regulations and Commission Orders, using the avoided cost methodology approved by this Commission and Duke's projections of full avoided cost used in determination by the North Carolina Commission. Tr., Keels, at 166-167.

Although Pacolet witness Mierek pointed to certain QF's in North Carolina as examples, Keels noted that, since the facilities were in North Carolina, they were subject to North Carolina rate schedules and, that upon close examination, Pacolet did not even want the levelized rates contained in those contracts. Tr., Keels, at 183.

Keels also noted that in 1993, Pacolet never responded to Duke Power's offer. Tr., Keels, at 172.

We would note that the testimony of the Commission Staff supports Duke Power's position that no bad faith took place in the Company's negotiations with Pacolet. Tr., Watts, at 253.

Finally, we deny Duke Power's Motion to Strike portions of Mierek's testimony. We agree that Mr. Mierek is not an attorney and not familiar with contract law. However, Mr. Mierek is an engineer that has had many occasions to deal with PURPA and its regulations while operating his QF. Accordingly, we agree with the assertions of the Commission Staff in its Brief that Mr. Mierek should be entitled to give his opinion on these matters. This Commission has the ability to judge the testimony's value and afford it whatever weight we deem appropriate.

In any event, the Complaint is hereby dismissed and denied. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

William Saunders

Chairman

ATTEST:

Gary E. Walsh

Executive Director

(SEAL)